



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	<b>07/05/00</b>	Bill No:	<b>SB 1949</b>
Tax:	<b>Sales and Use</b>	Author:	<b>Costa and Chesbro, et al.</b>
Board Position:	<b>Neutral</b>	Related Bills:	<b>SB 1933 (Vasconcellos) SB 1377 (Haynes) AB 2188 (Baldwin)</b>

### **BILL SUMMARY:**

This bill would require the Governor or his or her representative to enter into discussions with other states regarding the development of a multistate, voluntary, streamlined system for sales and use tax collection and administration, as specified.

### **ANALYSIS:**

#### Current Law:

Under current law, the California Internet Tax Freedom Act (Chapter 351 of 1998) specifies that the state may not impose or attempt to collect any tax on Internet access for three years beginning January 1, 1999. However, any existing tax, including any sales and use tax that is imposed in a uniform and nondiscriminatory manner, as specified, may be imposed. This means that state and local governments may impose sales and use taxes on all Internet sales, provided that the tax and its rate are the same as that which would be imposed on transactions conducted in a more traditional manner, such as over the phone or through mail order. Sales and Use Tax Law requires persons to pay use tax, as measured by the purchase price of the property, to the Board of Equalization (BOE) on purchases of tangible personal property for use in this state from out-of-state retailers. Persons who purchase items for use in this state from out-of-state retailers *who are engaged in business in California* pay use tax to the retailer, who must remit the use tax to the BOE.

Under current federal law, a three-year moratorium was also imposed on new Internet access taxes or other levies on electronic commerce, and expires in October 2001. That legislation also created the Advisory Commission on Electronic Commerce (ACEC) to study federal, state, local, and international taxation and tariffs on transactions using the Internet and Internet access. The ACEC's 19 members include three governors, heads of several major information technology corporations, and other government and business leaders from across the nation, including Board of Equalization Chair Dean Andal. The Commission issued its report to Congress on April 3, 2000.

Currently there is no requirement that a California representative enter into discussions with other states regarding multistate sales and use tax collection and administration.

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Proposed Law:

This bill makes various findings and declarations regarding the need to simplify the sales and use tax to reduce the administrative burden of collection. This bill would require the Governor or his or her representative to participate in discussions with other states regarding the development of a multistate, voluntary, streamlined system for sales and use tax collection and administration.

Those discussions may include, but would not be limited to the following: (1) The development of a "Joint Request for Information" from potential public and private parties governing the specifications for the system, (2) The mechanism for compensating parties for the development and operation of the system, (3) Establishment of minimum statutory simplification measures necessary for state participation in the system, and (4) Measures to preserve confidentiality of taxpayer information and privacy rights of consumers. The bill provides that the Governor or representative may proceed to issue a Joint Request for Information.

The Governor or his or her representative would be required to provide quarterly reports to the Speaker of the Assembly, Minority Leader of the Assembly, Senate Presiding Officer, and Senate Minority Leader, and to the chairs and members of the Assembly and Senate Committees on Revenue and Taxation on the progress of multistate discussions.

This bill would also require that, by March 1, 2001, the Governor or his or her representative report to the Speaker of the Assembly, Minority Leader of the Assembly, Senate Presiding Officer, and Senate Minority Leader, and to the chairs and members of the Assembly and Senate Committees on Revenue and Taxation on the status of multistate discussions and, if a proposed system has been agreed upon by participating states, shall also recommend whether this state should participate in that system.

This bill would become effective on January 1, 2001, and would remain in effect until, and be repealed as of, January 1, 2002.

Background:

In 1967, the Supreme Court ruled in *National Bellas Hess, Inc. v. Illinois Department of Revenue*, 386 U.S. 753 (1967), that a firm that has no link to a state except mailing catalogs to state residents and filling their orders by mail cannot be subject to that state's sales or use tax. The Court ruled that these mail order firms lacked substantial physical presence, or nexus, required by the Due Process Clause and the Commerce Clause of the Constitution. North Dakota enacted anti-Bellas Hess legislation with the expressed purpose of establishing nexus for mail order firms selling to consumers in the state, in an attempt to compel out-of-state retailers to collect the use tax on mail order sales and test the continuing validity of the Bellas Hess decision. That statute was challenged, and in 1992 the Supreme Court issued a ruling in *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992) that states cannot force out-of-state mail order firms to collect and remit use taxes on goods purchased by state residents, as it would be in violation of the Constitution's Commerce Clause, unless the retailer has state nexus.

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For example, L.L. Bean, the Maine catalog company, must only collect sales taxes from its customers in Maine. It would be an “undue burden,” the court said, for L.L. Bean or any other seller to have to keep tabs on the sales tax rates in each state and every city, as well as the numerous exemptions and special rules each jurisdiction may impose.

In addition, current law states that taking orders from California customers via a computer telecommunications network that is physically located in California does not create nexus for the retailer. Therefore, if L.L. Bean uses a California-based Internet service provider that provides a variety of on-line services to advertise its products and take orders, it isn’t obligated to collect sales tax on sales made through this provider. Federal legislation would be necessary for states to require mail order firms to collect use taxes.

#### COMMENTS:

1. **Sponsor and purpose of the bill.** This bill is sponsored by the author in an effort to address the collection and administration of sales and use taxes on Internet transactions. The National Governor’s Association and National Conference of State Legislatures have endorsed this model legislation. This proposal, intended to assist interested states in the development of a streamlined sales and use tax system, is also endorsed by several state and local organizations and was presented to the Advisory Commission on Electronic Commerce in December 1999. Any comprehensive nationwide simplification effort would have to be approved by Congress in order to avoid constitutional challenge. This bill would involve California in the ongoing discussions.
2. **Amendments to this bill since our last analysis of the May 26, 2000 version make a grammatical change and add co-authors.** These amendments do not change the analysis.
3. **This bill declares that states have the sovereign right to set their own tax policy.** As currently drafted, this bill would only require the Governor and his or her representative to enter into discussions with other states regarding the development of a multistate, voluntary, streamlined system for sales and use tax collection and administration. However, the discussions and participation with other states could lead to the establishment of a separate entity consisting of sales and use tax states that would impose sales tax policy for all member states and eliminate the ability of the Legislature to control state tax policy.
4. **The ACEC was created by Congress to study this issue.** The ACEC report contained the following concepts: (1) Extend the current moratorium on multiple and discriminatory taxation of electronic commerce for an additional five years, through 2006. (2) Prohibit taxation of digitized goods and their non-digitized counterparts to protect consumer privacy on the Internet and prevent the taxation of all services, entertainment, and information in the U.S. economy (both on the Internet and on Main Streets across America). (3) Make permanent the current moratorium on Internet access taxes, including those access taxes grandfathered under the Internet Tax Freedom Act. (4) Establish “bright line” nexus standards for American

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businesses engaged in interstate commerce, since the cyber economy has blurred the application of many nexus rules, and American businesses need clear and uniform tax rules and definitions before being exposed to business activity and sales and use tax collection obligations. (5) Encourage state and local governments to work with the National Conference of Commissioners on Uniform State Laws to simplify their own telecommunications and sales tax systems to ease burdens on interstate commerce. (6) Respect and protect consumer privacy in crafting any laws pertaining to online commerce generally and in imposing any tax collection and administration burdens on the Internet specifically. Their final report is available online at <http://www.ecommercecommission.org/report.htm>.

5. **Other organizations have already been formed to address tax administration in the new economy.** In addition to the ACEC, the National Tax Association (NTA), an association of government officials, tax practitioners, business representatives, and academicians includes a Communications and Electronic Commerce Tax Project that issued its final report in September 1999 (<http://www.ntanet.org>). The Organization for Economic Cooperation and Development (OECD), which is comprised of the United States and 28 other countries, is actively addressing taxation issues related to e-commerce from an international perspective (<http://www.oecd.org>). The Electronic Commerce Advisory Council (ECAC), which was created by Governor Pete Wilson by Executive Order W-175-98, released a report in November 1998 (<http://www.e-commerce.ca.gov>). The Multistate Tax Commission (MTC), of which the BOE is a member, developed the Sales Tax Simplification Project to address sales tax simplification for all sales tax states. The minutes from these conferences are posted on the MTC website (<http://www.mtc.gov>). And the Legislative Analysts Office issued its report, California Tax Policy and the Internet, in January 2000 (<http://www.lao.ca.gov>). In addition, many other states and organizations have become involved in Internet tax policy and numerous reports, with varying conclusions and recommendations, have been published on the topic.
6. **Related Legislation.** This bill is similar to SB 1933 (Vasconcellos) which would create the California Commission on Tax Policy in the New Economy to examine the impact of the Internet and other forms of electronic technology on the sales and use tax, telecommunications taxes, property taxes, and income taxes, as specified. Two other bills introduced this session, SB 1377 (Haynes) and AB 2188 (Baldwin), on which the Board was neutral, would eliminate the tax on Internet purchases.

#### **COST ESTIMATE:**

This bill would result in Board costs, to the extent that the Board is involved in the discussions. These costs would be related to staff participation, education, training, and equipment. These costs would be in the range of \$10,000 to \$50,000.

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**REVENUE ESTIMATE:**

This bill would not impact the state's revenues because it would merely require the Governor or his or her representative to discuss the development of a sales and use tax collection and administration system, particularly with respect to Internet transactions.

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